10 Questions to Ask Your Accountant

The end of the financial year is over; the accountant has lodged your last Business Activity Statement (BAS) for the year and sent you the financial statements for your business.

Generally, your accountant will have prepared two financial statements – the Profit and Loss Statement, and the Balance Sheet. Instead of only glancing at the bottom line of the Profit and Loss Statement to see how much money you made this year, take a good, long look at them.

If you know what to look for and the right questions to ask your accountant, you might be able to improve your profit for next year.

Profit and Loss Statement

As the name indicates the profit and loss statement measures the profit or loss of a business over a specified period. It summarises the income and subtracts the expenses incurred to calculate the profit or loss for the business over a period of time.

The main five components of a profit and loss statement are:

1. Income
2. Cost of goods sold
3. Gross profit
4. Expenses
5. Net profit

Balance Sheet

A balance sheet is a snapshot of what a business owns (assets) and what a business owes (liabilities). The difference between the assets and liabilities is called 'owners equity'. The equity must equal the assets minus the liabilities, hence the name balance sheet.

Understanding your figures is an essential skill for a successful small business owner. You should be able to understand and track the current financial health of your business without solely relying on your accountant.

See the Small Business Development Corporation (SBDC) webpage titled "Understand Your Accounts" for more information.

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1. How does my business compare with my competitors?

Ask your accountant to show you the business benchmarks relevant to your industry or visit SBDC and speak to one of our advisors. Benchmarks are a quick and easy way of comparing the performance of your business with industry averages. Is your business income better than average? Are you spending too much on wages? Business benchmarks will help spotlight areas in your business that may need some 'tweaking'!

2. What is included in my cost of goods sold?

COGS (cost of goods sold) are those costs that are incurred to produce a sale. It includes all the costs directly attributable to the acquisition or converting materials into finished goods. Items included in the COGS will differ from one type of business to another.

The lower your COGS, the higher your gross profit. Your COGS will vary, depending on the level of production or activity.

3. What is my gross profit (gross margin) percentage and is this reasonable for my type of business?

Gross profit is the difference between the value of the sales and the cost of sales. Understanding your gross profit is a really important building block for any small business owner, so spend some time with your accountant familiarising yourself with this figure and what it means!

Gross Profit Percentage = Gross Profit ÷ Sales x 100%

Increase your gross profit margin by increasing selling price or reducing cost of sales.

What can I do to increase my **gross profit margin?**

4. How can I reduce my expenses without compromising my quality or service?

If you don't know where your money is going, you won't know where to start controlling expenses – often it's the little things that add up.

Take a good look at each expense and ask yourself – will my business run just as well if I reduce this expense or cut it completely?

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5. How much net profit is my business making? Is this profit percentage worth all the effort I'm putting in?

On average Australian small businesses make 10% net profit annually, but this figure can depend on your industry type. How does your business compare? Ask your accountant to show you the business benchmarks relevant to your industry or visit SBDC and speak to one of our advisors.

6. What is my breakeven point and why is this important?

The breakeven point is the point at which your business is making neither a profit nor a loss. Knowing your breakeven point is critical for any business owner, because you will know exactly when you begin to make a profit.

The breakeven point is the lowest limit when determining profit margins. You will know how low a price you can offer, and the effects of discounting on your net profit.

You can calculate the break even for any period of time – a year, quarter, month, week, day – just make sure all three estimates relate to the same time period.

7. Which of my products or services are making me the most profit?

Look at the profit margin for each product or service you provide. Keep the ones that are giving you the highest return for the least effort. Discontinue the products or services that have a low profit margin and take great effort to provide.

And remember the 80/20 rule… typically 20% of your products or services will be generating 80% of your profit, so it might be time to review your product range.

8. What can I do to improve my cashflow?

One of the most immediate ways of improving your cashflow is to check how long it takes your customers to pay you.

It is important to collect all money that is rightfully yours on time. It's your money; if customers are paying late, you are effectively giving them an interest free loan! You do the work – insist on being paid on time. Make sure your customers are aware of your payment terms, and set time aside each week where you or your bookkeeper personally contacts clients to alert them that their account is due.

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9. How much money do I have invested in the business? Would my money be better invested elsewhere?

What would be the return on alternative investments such as property, shares, or long-term deposits? If you would earn considerably more for less effort and risk it might be time to reconsider your business.

10. Is my business in a good position financially - will it be able to survive a downturn?

Economic conditions can seriously affect your business. Are you in a strong enough position financially to be able to weather the storm? Ask your accountant about your debt to equity ratio.

The **debt to equity ratio** shows the proportion of capital invested by the business owners to the funds provided by external lenders. It gives a comparison of how much of the business was financed by owner's equity and how much was financed through debt or liabilities.

Generally, a debt to equity ratio in the range of 1:1 to 4:1 (ie a maximum of $4 debt for every $1 of owner's equity) is acceptable but will depend on individual business and industry circumstances.

Too much debt can put your business at risk and indicates possible difficulty in meeting interest and principal repayments.

Too little debt means you may not be taking advantage of opportunities and realising the full growth potential of your business.

BONUS QUESTION

How do I increase sales?

There are three ways to increase sales:

1. Increase the number of customers (or make sure they're the 'right customers')
2. Increase the frequency of transactions
3. Increase the value of your sales